

# The transformation and future prospects of Europe's defence industry

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Between the end of the Cold War and the present day, the European defence industry has undergone a dramatic transformation. In just over a decade this sector has transformed itself from a collection of medium-sized, nationally orientated firms to one dominated by two giants, with several smaller firms closely linked to these leaders. How this has happened is an intriguing story of politics and economics. We will argue in this article that four factors played key roles; and, after describing the evolution of this sector since the end of the Cold War, we will discuss each one in turn. They are: developments within the US defence industry; the impact of technology and defence economics; general economic restructuring within the EU, coupled with a nascent defence industrial policy; and progress towards the creation of a European Security and Defence Policy (ESDP). The first two factors are external to the EU, while the second two are internal, and specific to, the EU. While the evolution required all four factors, we argue that the EU itself played a critical and underappreciated economic and political role in the changes that have transformed the European defence industry, and will continue to shape this process.

## Europe's defence industry in the 1990s

Europe's defence industry entered the 1990s as a collection of national fiefdoms. While the US defence industry was rapidly consolidating during the first half of the decade, most European firms continued to look inwards. European consolidation at this time took the form of large national defence champions acquiring small domestic firms (a strategy pursued by Germany's Daimler-Benz), or big companies acquiring targets in EU countries with minor defence industries (for example, France's Thomson-CSF purchasing the defence electronics business

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**Table 1: Top ten European Union defence companies (1996)**

<i>Euro- pean rank</i>	<i>World rank</i>	<i>Company</i>	<i>Country</i>	<i>1995 rank (world)</i>	<i>1996 defence revenue<sup>a</sup></i>	<i>1996 total revenue<sup>a</sup></i>	<i>% of revenue from defence</i>
1	3	British Aerospace plc	UK	3	9,055	12,630	72
2	6	General Electric Co. plc	UK	9	6,057	18,939	32
3	8	Thomson Group	France	8	4,433	6,931	64
4	10	Lagardere Group	France	12	3,830	11,060	35
5	13	Daimler-Benz Aerospace AG	Germany	13	3,225	8,404	38
6	14	Direction des Constructions Navales	France	14	3,045	3,045	100
7	17	Alcatel-Alsthom SA	France	63	2,287	30,977	7
8	19	Aérospatiale	France	16	2,237	9,727	23
9	20	Rolls-Royce plc	UK	27	2,059	6,864	30
10	24	GKN	UK	33	1,633	5,670	29

<sup>a</sup> US\$ million.

Source: Figures derived from the *Defense News* 1997 'Top 100 Table', accessed on 10 November 1997 at <http://www.defensenews.com/top100/top100a.htm>.

of the Dutch company Philips, or France's Giat buying Fabrique Nationale of Belgium). Those transnational collaborations that did exist generally took the form of joint ventures (for products like missiles) or multinational consortia (like the Eurofighter)—both of which enabled defence firms to maintain their national independence. The 'urge to merge' cross-border was hindered by the reluctance (in some cases, refusal) to accept the acquisition of a domestic company by a foreign firm. This concern was most evident in the political realm, as national governments fretted about the loss of sovereignty (particularly the insecurity that armaments might not be readily available) and the political consequences of restructuring-induced job losses that might accompany such an acquisition. However, executives were almost as resistant to industry-wide rationalization. Many feared the uncertainty that would follow mergers and acquisitions in terms of their own position within new entities, but also with respect to the cosy relationships they had cultivated through the years for their own firms with their 'home' defence ministry. Governments and defence firms held monopsonist and monopolist positions, respectively, in each country. The extent to which these links would be weakened by Europe-wide industrial restructuring was unclear. The status quo was the safest option for both government and business. Table 1 ranks the top ten European defence firms in 1996.

By the late 1990s, this situation had become untenable. For reasons described below, European defence firms found themselves under political and economic pressure to consolidate. The first major consolidation occurred in the UK in

January 1999, when GEC agreed to sell its defence arm (Marconi Electronic Systems) to British Aerospace. The new entity was renamed BAE Systems. Until weeks before the acquisition, British Aerospace had been actively engaged in talks with Dasa, the aerospace unit of Germany's DaimlerChrysler, with a view to creating the first truly pan-European aerospace company. The last-minute decision by the British to opt for an internal merger angered not only the Germans but also the French, who had been expected to join the new pan-European entity. Many experts concluded that the British decision had delayed the creation of a unified European aerospace and defence company indefinitely.<sup>1</sup>

Yet, only nine months later, the European behemoth that many thought impossible without British participation was born—a development spurred by the formation of BAE Systems. The first step, as in the UK, was national consolidation. As part of its privatization in June 1999, France's *Aérospatiale* fused with Matra to create an aerospace and defence electronics powerhouse. Four months later, this combined entity merged with Dasa to form the European Aeronautic Defence and Space Company (EADS). CASA, Spain's leading aerospace and defence firm, also merged with EADS.

Similar consolidation occurred in other defence sectors. In October 1997 the French government announced that it would privatize Thomson-CSF and bring Dassault Electronique, the space and defence electronics businesses of Alcatel, and the satellite businesses of *Aérospatiale* within the company. Thomson-CSF acquired Racal Electronics of the UK in June 2000 and, to reflect its new global breadth, was renamed Thales.<sup>2</sup> Two companies now account for Europe's helicopter business. One is Eurocopter—a division of EADS. The second was created in 2001 when Italy's Agusta merged with the UK's Westland to form AgustaWestland. The joint venture (owned equally by Finmeccanica and GKN, the parents of Agusta and Westland) is the world's second largest helicopter company (after Boeing). MBDA, the world's second largest maker of missiles (behind Raytheon), was also formed in 2001 by merging the missile interests of EADS, BAE Systems and Finmeccanica.

Simultaneously with the rationalization and restructuring of individual European defence companies, Airbus was being reorganized. Formed in 1970 to counter the industry dominance of US aerospace companies (particularly Boeing), Airbus previously operated as a consortium under which the four partners (*Aérospatiale*, Dasa, British Aerospace and CASA) kept ownership of their engineering and production assets. During the 1990s calls for a reorganization of Airbus increased both among the consortium's partners and from outsiders who argued that changing Airbus's legal corporate status would increase its competitiveness *vis-à-vis* Boeing. Airbus is now owned by EADS (80 per cent) and BAE Systems (20 per cent). In 2001 Airbus, now a division of EADS, accounted for about two-thirds of EADS turnover.

<sup>1</sup> 'Transatlantic aerobatics', *The Economist*, 5 June 1999, pp. 59–60.

<sup>2</sup> The renaming also conveniently distanced the firm from the corruption of the former Thomson-CSF. See 'A survey of the defence industry', *The Economist*, 20 July 2002, p. 6.

**Table 2: Top ten European Union defence companies (2000)**

<i>Euro- pean rank</i>	<i>World rank</i>	<i>Company</i>	<i>Country</i>	<i>1999 rank (world)</i>	<i>2000 defence revenue<sup>a</sup></i>	<i>2000 total revenue<sup>a</sup></i>	<i>% of revenue from defence</i>
1	4	BAE Systems	UK	3	13,248	18,399	72
2	7	EADS	France	6	4,560	22,799	20
3	8	Thales	France	8	4,262	7,411	58
4	15	Rolls-Royce plc	UK	18	2,179	9,108	24
5	17	Smiths Industries	UK	35	1,698	4,415	39
6	20	GKN Group	UK	17	1,415	7,203	20
7	23	Direction des Constructions Navales	France	19	1,238	1,728	72
8	26	Finmeccanica	Italy	28	1,178	5,355	22
9	28	Saab Group	Sweden	22	1,119	1,671	67
10	32	Dassault Aviation S.A.	France	33	991	3,415	29

<sup>a</sup> US\$ million.

Source: Figures derived from *Defense News* 2001 'Top 100 Table', which can be accessed (subscription required) at <http://www.defensenews.com/current/top100/2001chart1.html>.

As a result of these developments, two defence firms (BAE Systems and EADS) now dominate Europe, and Thales is almost EADS's equal on the measure of defence revenues (see table 2). As we have shown, the paths of these mergers appear to represent two different strategies of consolidation. BAE Systems might be called a 'hypernational champion', having consolidated much of the national defence infrastructure of the UK into one company, without any major cross-border ties. EADS, on the other hand, was formed via a 'merger of mergers'. With EADS, sectoral consolidation did not terminate at the national level. Instead, national consolidation forged newly merged entities that would be in a stronger position to negotiate transnational ventures. Thus, the strategy leading to the creation of EADS was to pursue transnational mergers within similar sectors of the defence industry (aerospace, missiles, etc.) by the 'national champions' of individual countries.

Why has EADS been successful with the 'merger of mergers' concept when other notable efforts at cross-border consolidation have failed? The best explanation is that the exigencies of the new defence market had finally become impossible for industry executives to ignore. The creation of EADS was not driven by the national leaders who had for years been preaching the importance of consolidation—sermons that inevitably came to naught over the political price of job losses; on the contrary, during the highly secret discussions that led to EADS, the industry executives involved made a conscious and calculated decision to keep their respective national leaders uninformed of the plans until

the negotiations had reached an advanced stage.<sup>3</sup> By such discretion, political meddling in what was essentially a business decision was kept to a minimum.

Indeed, in the case of BAE Systems (which also owns a 35 per cent interest in Saab, Sweden's leading defence firm), what may at first glance look like a 'national champion' may in fact be a test case of a new breed of firm: a genuine Atlantic partnership between the United States and a defence company across the water.<sup>4</sup> One reason why British Aerospace opted to merge with GEC rather than Dasa was in order to acquire Tracor, GEC's largest subsidiary in the United States.<sup>5</sup> Any formal merger between BAE Systems and a US firm is probably years away, but British firms, especially the old British Aerospace, always enjoyed preferential access to US firms and technology. Such access is critical today, as US officials after 11 September are even more nervous about the possibility of sophisticated technology falling into enemy hands by way of European defence contractors. The British are trusted with technology, and are allowed to buy into the US market, in a way that the French and Germans are not.<sup>6</sup>

The creation of EADS, far from isolating BAE Systems,<sup>7</sup> has to date spurred it to cement links with US firms, until it has become almost as 'multinational' as EADS. In the case of both EADS and BAE Systems, the Europeans have formed defence titans that can finally match the heft and clout of their American cousins.<sup>8</sup> This is ironic, since one of the major causes of the European consolidation was the bow wave emanating from the defence mergers on the other side of the Atlantic.

## **External forces**

### *The US defence industry*

With seven of the top ten defence companies in the world, the pacesetter in global armaments production is the United States (see table 3). Historically, the engine of growth for the US defence industry was strong domestic demand, aided by the fortuitous advent of the Cold War. Times were especially prosperous from the late 1970s to the late 1980s. During this decade, no expense was spared in America's quest for greater quantities of munitions. By the early 1990s, however, the tide had turned.

In part, the defence companies were victims of their own success. As the costs of weapons soared and capabilities improved, it is likely that even without

<sup>3</sup> John Rossant, 'Airbus: birth of a giant', *Business Week* (international edn), 10 July 2000, [http://www.businessweek.com/2000/00\\_28/b3689015.htm](http://www.businessweek.com/2000/00_28/b3689015.htm).

<sup>4</sup> Anne Marie Squeo, Jeff Cole and Dan Michaels, 'British Aerospace takes center stage in talk of trans-Atlantic defence deals', *Wall Street Journal*, 18 Oct. 1999, p. A3; Alexander Nicoll, 'Raytheon and Thales in air defence joint venture', *Financial Times*, 15 Dec. 2000, p. 9.

<sup>5</sup> 'A Survey of the Defence Industry', *The Economist*, p. 12.

<sup>6</sup> *Ibid.*, pp. 13, 16.

<sup>7</sup> Alan Cowell, 'Rivals' deal raises questions on fate of British Aerospace', *New York Times*, 19 Oct. 1999, p. C4.

<sup>8</sup> 'Europe gets a defence giant', *The Economist*, 16 Oct. 1999, pp. 63-4.

**Table 3: Top ten defence companies, worldwide (2000)**

World Company rank	Country	1999 rank	2000 defence revenue <sup>a</sup>	2000 total revenue <sup>a</sup>	% of revenue from defence
1 Lockheed Martin Corp.	US	1	18,000	25,329	71
2 Boeing Co.	US	2	17,000	51,321	33
3 Raytheon Co.	US	4	14,033	16,895	83
4 BAE Systems	UK	3	13,248	18,399	72
5 General Dynamics Corp.	US	5	6,542	10,356	63
6 Northrop Grumman Corp. <sup>b</sup>	US	7	5,600	7,618	74
7 EADS	France	6	4,560	22,799	20
8 Thales	France	8	4,262	7,411	58
9 United Technologies Corp.	US	10	4,130	26,583	16
10 TRW Inc. <sup>b</sup>	US	9	4,000	17,200	23

<sup>a</sup> US\$ million.<sup>b</sup> Agreed to merge 1 July 2002.

Source: Figures derived from *Defense News* 2001 'Top 100 Table', which can be accessed (subscription required) at <http://www.defensenews.com/current/top100/2001chart1.html>.

the compounding factor of the Cold War's resolution, some restructuring would have occurred in the US defence industry. But as the defence budget was slashed in search of a 'peace dividend', the industry realized that the halcyon days of the Reagan build-up were over. Military spending declined from \$400 billion in 1989 to \$281 billion in 2001, with the steepest fall coming in the mid-1990s.<sup>9</sup> Prodded by then Secretary of Defense Les Aspin's 'last supper' in 1993,<sup>10</sup> the industry hastened to adjust. Layoffs by firms such as Northrop, Hughes, Lockheed, General Dynamics, Litton Industries and TRW marked a spate of 'downsizings' and acquisitions, culminating in the mergers of Lockheed and Martin Marietta, Boeing and McDonnell Douglas, and Raytheon and Hughes. Nowhere was this industry rationalization more apparent than in the military aerospace sector. Whereas in 1987, the United States had seven major producers of military fighters or bombers,<sup>11</sup> today it has two behemoths, Lockheed Martin and Boeing, and a somewhat smaller firm, Northrop Grumman.

<sup>9</sup> Information from the Stockholm International Peace Research Institute (SIPRI): [http://first.sipri.org/non\\_first/result\\_milex.php](http://first.sipri.org/non_first/result_milex.php), (figures in 1998 dollars).

<sup>10</sup> Secretary Aspin and Deputy Secretary William Perry invited a dozen defence industry executives to dinner at the Pentagon. Aspin told the assembled group that there were twice as many people at dinner as the government wanted in five years' time, and warned that the Department of Defense was ready to see some firms exit the market. The implied threat, 'combine or die', along with a policy of government subsidies covering some merger-related costs, helped to speed rationalization of the US defence industry. See Norman Augustine, 'Reshaping an industry: Lockheed Martin's survival story', *Harvard Business Review*, May-June 1997, pp. 83-94; John J. Dowdy, 'Winners and losers in the arms industry downturn', *Foreign Policy* 104, Summer 1997, pp. 88-101.

<sup>11</sup> Lockheed, Martin Marietta, General Dynamics, Boeing, McDonnell Douglas, Northrop and Grumman.

In the United States, defence firms responded to dwindling demand via a logical market reaction: consolidation. The corresponding reaction was long delayed across the Atlantic. Yet, as the Europeans struggle to catch up, the story of the US min-now, Northrop Grumman, caught between the sharks of Lockheed and Boeing is informative, and may tell a cautionary tale to other (particularly European) governments singing the belated praises of consolidation-induced efficiencies.

Originally, had consolidation been pursued to its logical conclusion in the United States, Northrop would have been absorbed by one of the two giants. In fact, Lockheed Martin made a play for Northrop Grumman in 1997, and it was widely assumed that the US government would approve the merger, it being the final logical step in the chain of events prompted by the 'last supper' four years before. With one acquisition following another, however, both the defence and the justice departments had become increasingly worried about the lack of competition in the defence marketplace.<sup>12</sup> Abruptly, in 1998, the US government announced that it would oppose the merger. Asked whether the US government's position on mergers had changed, the then Secretary of Defense, William Cohen, said the policy was the 'same policy that has existed before ... To the extent that companies can merge and consolidate without hurting competition in the defence industry, the Defence Department would support that.' He added, however: 'When you get fewer and fewer players in the industry, then you get greater scrutiny.'<sup>13</sup>

The question that was being asked, implicitly, in the halls of the Justice Department and at the Pentagon, was whether defence consolidation had reached its 'optimum level of efficiency'. In theory, there exists an optimum point at which the marginal benefits of consolidation just outweigh the marginal costs of limited competition. In practice it may be impossible to determine whether an entire defence sector has reached this point; but the officials who judged the Lockheed Martin/Northrop Grumman marriage clearly felt that further consolidation might bring negative consequences to a sector that already had precious few suppliers. In the European rush for consolidation, the bulk of which transpired after the failed Lockheed Martin/Northrop Grumman merger, to what extent officials in London, Paris, Berlin and Brussels are eyeing an 'optimum level of efficiency' remains unclear.

In calculating the theoretical efficiency level, how one defines the size of the market is of critical importance. While leery of more domestic mergers, some US defence officials (in both government and industry) have been quietly floating the idea of an Atlantic partnership.<sup>14</sup> Such a transatlantic merger would

<sup>12</sup> Thomas E. Ricks and Jeff Cole, 'How Lockheed Martin misread the radar on Northrop merger', *Wall Street Journal*, 19 June 1998, p. A1.

<sup>13</sup> Thomas E. Ricks, 'Cohen says Pentagon policy on defence mergers unchanged', *Dow Jones Newswires*, 6 April 1998.

<sup>14</sup> Anne Marie Squeo and Jeff Cole, 'Defence firms mull trans-Atlantic deals', *Wall Street Journal*, 19 July 1999, p. A2; Thomas E. Ricks, Anne Marie Squeo and Jeff Cole, 'Pentagon discussing with Europeans possibility of mergers with US firms', *Wall Street Journal*, 7 July 1999, p. A2; Jeffrey Becker, 'The future of Atlantic defence procurement', *Defence Analysis* 16: 1, 2000, pp. 9-32.



need to have congressional approval, and would have to ensure the safety of key US technologies. Nevertheless, expanding the theoretical market also simultaneously expands the number of possible competitors, allowing firms to wring more savings out of consolidation while preserving the benefits of competition.

As discussed above, BAE Systems remains a prime candidate for an intercontinental merger, although the minnow, Northrop Grumman, was also known to be on the menu of some European firms (albeit before Northrop Grumman fended off BAE Systems to acquire TRW in July 2002). BAE Systems, moreover, put in place many of the safeguards the US Congress would require of foreign firms when it completed the Tracor deal.<sup>15</sup> Whether or not the dream of an 'Atlantic defence partnership' becomes reality, however, it is clear that events in the US defence industry played a key role in prompting European firms to restructure in a similar fashion.

### *Technology and defence economics*

The 1991 Gulf War, the 1999 bombing of Kosovo, and recent operations in Afghanistan graphically illustrate the technological superiority of the weapons used by US military forces. These conflicts proved that elaborate command, control, communications, computers and intelligence (C4I) systems are devastating force multipliers in combat situations. While the bang may be greater, however, the buck is increasing disproportionately. The average price of fighter planes worldwide increased 10,000 per cent in constant US dollars from 1945 to 1985. More recently, the real price of tactical combat aircraft has been growing at 10 per cent per year. The only way to recover these costs is to lengthen production runs,<sup>16</sup> and this is best done by consolidating several small companies into a very few large ones.

The Gulf War, Kosovo and Afghanistan also illustrate another trend, this one at cross-purposes to production run lengthening: the paucity of opportunities to use cutting-edge weaponry. The threats of the Cold War are gone, and today's defence planners are kept awake not by trying to defend the Fulda Gap, but by keeping phantom terrorists at bay. The real lesson of Kosovo may have been not how far Europe had fallen behind the United States in precision death gadgets, but the economic and strategic folly of fighting ethnic cleansers with high technology. The damage in Kosovo was done, for the most part, by groups of marauders with decidedly low-tech weapons. To counter that threat, the United States relied on 'smart bombs' costing \$1 million each.<sup>17</sup> The economics of using million-dollar weapons to hit thousand-dollar targets is questionable, to say the least. Granted, part of the rationale was to limit 'collateral damage'; but part of it was also that, in this age, to justify supply you must create demand.

<sup>15</sup> 'A survey of the defence industry', *The Economist*, p. 13. Note that BAE Systems also successfully acquired Lockheed Martin's aerospace electronics systems business in 2000.

<sup>16</sup> Robert Callum, 'The Eurofighter consortium: a harbinger of rationalization for the European defence industry?', *National Security Studies Quarterly* 4: 1, 1998, pp. 21–40.

<sup>17</sup> Eric Schmitt, 'It costs a lot more to kill fewer people', *New York Times*, 2 May 1999, p. WK5.



Even with the manufactured opportunities of Kosovo, demand for new weapons will never reach Cold War levels. Coupled with the high cost of new munitions, which need longer production runs to be profitable, the economic logic of defence consolidation becomes clear.

With a need for long runs of weapons, but a difficulty in justifying those runs on the basis of domestic defence concerns, a natural reaction is to make more than necessary and sell the excess on the export market. During the Cold War, with demand seemingly infinite, this strategy often paid healthy dividends for European countries (notably France and the UK) that wanted to support a robust defence infrastructure without relying solely on domestic consumption. This strategy is much more difficult to implement today, with global conventional weapons exports falling from \$20.2 billion in 1992 to \$16.2 billion in 2001.<sup>18</sup> With worldwide demand for arms plummeting, the export market has become both crowded and severely competitive, with many new entrants pushing costs down and making consolidation among producers almost a necessity.<sup>19</sup>

In this environment European firms suffer several handicaps. Effective lobbying has helped US defence companies to benefit from generous government support, and these firms are now pre-eminent in developing and integrating C4I systems.<sup>20</sup> European industry is relatively weaker because fewer resources have been devoted to developing C4I, and there has been little in the way of pooling resources by national governments, even for C4I research and development (R&D). To compound the problem, many C4I technologies are based on advances in commercial information technologies, such as communications, computers and software—areas in which US firms have a considerable advantage over European companies.

Nevertheless, the formation of BAE Systems and EADS is a positive harbinger for the future health of the European industry. Partly by stealth (as described above in connection with the formation of EADS), the political opposition to consolidation has been overcome. Nor was it just stealth tactics that helped to overcome European politicians' resistance to consolidation; it was stealth technology as well. The performance of American weaponry in Kosovo served as yet another sign of just how far behind Europe had fallen in defence development. While European leaders had engaged in similar hand-wringing after the Gulf War, there is now some evidence that Europe will at least attempt to close the resource gap that exists between US and European defence expenditures.<sup>21</sup> BAE Systems and EADS, which like their US brethren

<sup>18</sup> Information from SIPRI: <http://projects.sipri.se/armstrade/appx8B2002.pdf> (figures in 1990 dollars).

<sup>19</sup> Callum, 'The Eurofighter consortium'; Robert Callum, 'Dogfight: exporting supersonic combat aircraft in the post-Cold War era', in Gerald Susman and Sean O'Keefe, eds, *The defence industry in the post-Cold War era: corporate strategies and public policy perspectives* (Oxford: Pergamon, 1998), pp. 103–17; Greg Schneider, 'Arms race shaping up between American and European firms', *Washington Post*, 30 July 2000, p. A06.

<sup>20</sup> John Deutch, Arnold Kanter and Brent Scowcroft, 'Saving NATO's foundation', *Foreign Affairs* 78: 6, Nov.–Dec. 1999, pp. 54–67.

<sup>21</sup> Philip H. Gordon, 'Their own army? Making European defence work', *Foreign Affairs* 78: 4, July–Aug. 2000, pp. 12–17; David S. Yost, 'The NATO capabilities gap and the European Union', *Survival* 42: 4, Winter 2000, pp. 97–128.

have solid beachheads in both the defence and commercial worlds, should be able to find and exploit 'next generation' defence technologies, and help ensure that Europe does not fall behind again.

## Internal factors

### *European economic restructuring*

The EU's explicit role in defence industrial policy is restricted by treaty. Article 223 of the Rome Treaty (article 296 in the Amsterdam Treaty) allows any member state to 'take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions, and war material'. Despite the article's subsequent clause that 'such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes', the EU's more integrative bodies (the Commission and Parliament) and member states have been unable to persuade the intergovernmentalists (the Council and, among member states, the UK and France in particular) to allow the defence industry to be governed by EU regulations that apply to virtually every other economic sector.

As a result, during the first half of the 1990s the EU developed an 'arm's length' defence industrial policy.<sup>22</sup> In actuality, it was more a collection of ad hoc policies administered by several directorates-general (DGs) within the Commission. For example, in 1994 the Commission began identifying 'dual-use' goods for international trade purposes and the Council created a list of permitted or proscribed destination countries. This dual-use export control regime was revised in 2000 out of concern for the legality of such a two-pillar approach, with the Commission's role enhanced.<sup>23</sup> The EU's authority in competition matters has empowered the Commission to vet mergers among European firms engaged in weapons production activities, although some countries have exercised their right to exclude the defence businesses of merging companies from the Commission's review. The EU's framework programmes support R&D in information technology, industrial materials and telecommunications—all of which have civilian as well as military applications. A Commission Green Paper on public procurement estimates that around one-third of defence spending is already covered by the EU's public procurement directives.<sup>24</sup> The EU, through its structural funds for regions in need of economic development, developed the Perifra and, later, Konver programmes to accelerate the diversification of

<sup>22</sup> Terrence Guay, *At arm's length: the European Union and Europe's defence industry* (Basingstoke: Macmillan; New York: St Martin's Press, 1998).

<sup>23</sup> For the history of, and all documents related to, the trade of dual-use goods in the EU, see [http://europa.eu.int/comm/trade/goods/dualuse/index\\_en.htm](http://europa.eu.int/comm/trade/goods/dualuse/index_en.htm).

<sup>24</sup> Commission of the European Communities Green Paper, *Public procurement in the European Union: exploring the way forward*. Communication adopted by the Commission on 27 November 1996 on the proposal of Mr Monti.

economic activities in regions heavily dependent on the defence sector.<sup>25</sup> Finally, in June 1998, EU member states adopted a voluntary code of conduct on arms exports. While the code commits governments in principle to consult one another when considering whether to grant export licences to countries that have been denied them by other member states on human rights grounds, it is not legally binding. Thus, by mid-1998, the EU had a loose collection of policies regulating various aspects of Europe's defence firms, but (unlike the US) no comprehensive policy that would guide or even assist the restructuring of this industry.

By mid-1994 there was significant support within the Commission and Parliament for a more explicit EU defence industrial policy.<sup>26</sup> Indeed, over the next three years, the Commission published three major documents on the subject: *The challenges facing the European defence-related industry*, *Implementing European Union strategy on defence-related industries* and a *Draft action plan for the defence-related industry*.<sup>27</sup> The last of these describes fourteen areas in which immediate EU action is deemed necessary, including the standardization of defence equipment and national export policies, the incorporation of the defence industry sector into the EU's competition policy and state aid regulations, and cooperation in armaments R&D and procurement. Although one observer suggests that the Commission's approach to these documents was shaped by competition between market and defence 'frames' of relevant DGs, the more important point is that the Commission was actively seeking to bring the defence industry within the general purview of the EU and the single market programme.<sup>28</sup>

More broadly, by the late 1990s European governments in general were pursuing policies of economic liberalization. The adoption of a more 'Anglo-Saxon' mindset was largely a response to the success of the US economy. What Europe needed, many critics contended, was to become more like the United States, and the policy prescriptions were privatization, deregulation and liberalization. By the late 1990s, privatization of state-owned companies in France was moving more quickly under the Socialist Jospin government than it had under the country's more conservative predecessors, and Italy's IRI developed plans to sell off parts of its empire. While France attracted much attention for the enactment of a law limiting the working week to 35 hours, most countries (including France, Spain and the Netherlands) were passing laws promoting labour flexibility. In addition, the implementation of a common currency represented a kind of culmination of the economic renewal that the 1985 Single European Act (SEA) was designed to stimulate. In fact, it is possible that the

<sup>25</sup> Konver, which replaced Perifra, ended in 1999.

<sup>26</sup> Interviews conducted in Brussels, May and June 1994.

<sup>27</sup> Commission of the European Communities, *The challenges facing the European defence-related industry: a contribution for action at European level*, COM (96) 10 final; *Implementing European Union strategy on defence-related industries*, COM (97) 583 final; *Draft action plan for the defence-related industry* (Brussels: Directorate-General III, 20 Aug. 1997).

<sup>28</sup> Ulrika Morth, 'Competing frames in the European Commission: the case of the defence industry and equipment issue', *Journal of European Public Policy* 7: 2, June 2000, pp. 173–89.

arrival of the euro, and confidence in the success of a common currency, constitute a major reason why Europeans became more receptive to the idea of further integration in defence.<sup>29</sup> Restructuring of the defence sector in the late 1990s, therefore, must be understood in this broader context.

### *A European Security and Defence Policy (ESDP)*

While EU economic policies have undoubtedly had some effect on the operations of European defence companies, it would be difficult to make the claim that these policies played a decisive role in the restructuring of this sector over the past few years. Instead, we need to look at political changes within the EU, particularly recent moves towards a common defence policy.

While EU members have debated the merits of cooperation in the foreign, security and defence policy areas since the 1950s, it was not until the 1991 Maastricht Treaty that they took a step that attracted real attention from the world (and academic) community. The Common Foreign and Security Policy (CFSP) formed the second of the three pillars supporting the newly created EU. While hopes were high that the CFSP would give the EU more international political influence to match its economic weight, the CFSP was by the mid-1990s coming under severe criticism in the light of the EU's inability to end the violence in the Balkans. The transformation of the CFSP into an EU defence policy, a goal of several member states (particularly France) during the Maastricht negotiations, seemed most unlikely by the time the Dayton peace accords were signed in December 1995. Still, the 1997 Amsterdam Treaty sought to develop a common EU defence policy and a European Security and Defence Identity (ESDI). Specifically, the Amsterdam Treaty defined the EU's common defence policy to include 'humanitarian and rescue tasks, peacekeeping tasks and tasks of combat forces in crisis management, including peacemaking'—the so-called 'Petersberg tasks' outlined by the Western European Union (WEU) in 1992.

It is an irony that the UK played a pivotal role in this transformation, with the Blair government expressing openness to European cooperation in defence policy. Reaching agreement first with the French in the December 1998 St Malo declaration, the UK became the key member state in advancing the EU's steps in defence. Among other things, the declaration stated that the EU 'must have the capacity for autonomous action, backed up by credible military forces'; 'must be given appropriate structures and a capacity for analysis of situations, sources of intelligence and a capability for relevant strategic planning'; and 'will also need to have recourse to suitable military means'.<sup>30</sup> British acceptance that a credible ESDP is conceptually compatible with a strengthened NATO alliance is indeed a 'revolution in military affairs'.<sup>31</sup>

<sup>29</sup> Margarita Mathiopoulos and István Gyarmati, 'Saint Malo and beyond: toward European defence', *Washington Quarterly* 22: 4, Autumn 1999, pp. 65–76.

<sup>30</sup> Joint Declaration on European Defence, Saint-Malo Franco-British summit, 4 Dec. 1998.

<sup>31</sup> Jolyon Howorth, 'Britain, France, and the European Defence Initiative', *Survival* 42: 2, Summer 2000, pp. 33–55.

The St Malo declaration came just one month after the first ever meeting of EU defence ministers, and six months before the European Council endorsed the Franco-British approach at Cologne. An Italian-British summit in July 1999 and then preparations for a follow-up Franco-British meeting that December set the stage for the December Helsinki European Council, which committed the EU to 'develop an autonomous capacity to take decisions and, where NATO as a whole is not engaged, to launch and conduct EU-led military operations', as well as a timetable for the creation of a rapid reaction force.<sup>32</sup> As Michael Clarke notes, '[w]ithin little more than a year Britain and France had consciously—and with some vigorous and sensitive diplomacy—manufactured a sea change in the tides of alliance politics.'<sup>33</sup>

At the December 2000 Nice summit, EU members pledged 100,000 troops, 400 aircraft and 100 ships to form a 60,000-strong rapid reaction force which could be sent to deal with regional conflicts or humanitarian crises. While cautiously presenting this force as representing something less than the establishment of a European army, so as not to rattle NATO supporters, the EU has with its creation taken a huge step down the path towards a common defence policy—one that raises concerns about an absence of a common European strategic vision among member states.<sup>34</sup> However, the industrial dimension of an EU rapid reaction force also raises concerns, especially since the capability to send up to 60,000 troops anywhere in the world at 60 days' notice and sustain them for a year would place considerable strains on the military equipment and infrastructure of participating EU countries.<sup>35</sup> Nonetheless, the scepticism directed at the CFSP in the mid-1990s had by 2000 given way to a more nuanced appreciation of the EU's impact as an international actor,<sup>36</sup> and by early 2001 to a major EU policy initiative in defence. Europe's defence industry was a major beneficiary of this development, as political leaders who held a new vision of European defence encouraged economic restructuring. It was the same vision, moreover, that the industry titans had been furthering among themselves since 1999.

## **Europe's defence industry in the twenty-first century**

To summarize, we argue that factors both external and internal to the EU are responsible for the restructuring of Europe's defence industry. Timing is key to understanding this. Given its dispersion among several countries, it was unlikely that Europe's defence industry would undertake much serious reorganization before the US sector. The experience of the Gulf War and, more significantly,

<sup>32</sup> Presidency reports to the Helsinki European Council on 'Strengthening the Common European Policy on Security and Defence', 10–11 Dec. 1999, para. 27.

<sup>33</sup> Michael Clarke, 'French and British security: mirror images in a globalized world', *International Affairs* 76: 4, 2000, p. 733.

<sup>34</sup> François Heisbourg, 'Europe's strategic ambitions: the limits of ambiguity', *Survival* 42: 2, Summer 2000, pp. 5–15.

<sup>35</sup> Alexander Nicoll, 'EU paves way for defence arm', *Financial Times*, 21 Nov. 2001, p. 22.

<sup>36</sup> Roy Ginsberg, *The European Union in international politics: baptism by fire* (Lanham, MD: Rowman & Littlefield, 2001).

the bombing of Kosovo added urgency to the restructuring if Europe was to have any hope of closing the defence technology gap with the United States. The St Malo and Helsinki declarations provided the political support for private sector reorganizations. For instance, it is unlikely that the French government would have acquiesced to a merger between Aérospatiale and Dasa much before 1999. Finally, the success of the SEA and the common currency programme, and the EU's negotiating power in trade policy, make it increasingly anachronistic to keep the defence sector 'at arm's length' from the institution. In the late 1990s these factors served as the catalyst for European defence industry reorganization. The context of the EU explains why the mergers and restructuring occurred almost entirely among EU companies, and not between EU and non-EU companies (that is, firms in the US, Switzerland, Japan, etc.).

So what happens next? We identify four issues, themselves components of external and internal forces, which will play a key role in determining where Europe's defence industry goes from here. The first relates to the EU. The EU continues to wrestle with the idea of a defence industrial policy. One obstacle to its development is a shifting balance of power within the EU. The Commission began the 1990s viewed as a leader and 'policy-entrepreneur',<sup>37</sup> but ended the decade in disgrace when the Commissioners resigned *en masse* under Jacques Santer. The Parliament, while seeing its powers gradually increased with the Maastricht, Amsterdam and Nice treaties, remains the weakest of the three institutions in the foreign policy area. This is not due to a paucity of views on foreign policy. For example, Parliament responded to the Commission communication *Implementing European Union strategy on defence-related industries* with a resolution declaring that European armaments policy, 'an essential element in the gradual development of a common defence policy, is linked to both the CFSP and Community policies, in particular on industry, trade, customs, the regions, competition, innovation and research' (amendment 7).<sup>38</sup> Despite such efforts, the Council continues to be the centre of decision-making for the shape and timetable of an EU defence dimension.

One result of this resistance to bringing the defence sector within the single market programme is the awkwardness that the Commission faces in vetting mergers of European and US defence firms. Because the British and French governments invoked article 223 (now 296), the EU was not allowed to review the defence implications of the British Aerospace-GEC, GEC-VSEL or Aérospatiale-SNPE mergers. However, the EU raised the ire of government and industry officials in the United States when it required Boeing to modify its 1997 merger with McDonnell-Douglas. Demands by Brussels in 2001 that General Electric make some aerospace-related disposals as a condition for approval of its

<sup>37</sup> Neill Nugent, 'The leadership capacity of the European Commission', *Journal of European Public Policy* 2: 4, Dec. 1995, pp. 603-23; Wayne Sandholtz and John Zysman, '1992: recasting the European bargain', *World Politics* 42: 1, Oct. 1989, pp. 95-128.

<sup>38</sup> European Parliament, Resolution on the Communication from the Commission on Implementing European Union Strategy on Defence-related Industries, 28 Jan. 1999 (A4-0482/1998).



acquisition of Honeywell were rejected by the US company, resulting in the blockage of the merger by the EU.<sup>39</sup> To some US policy-makers and industrialists, it probably appeared as if the EU had more influence over defence industry mergers in the United States than those in Europe.

This does not mean, however, that the Commission has abandoned defence industrial policy to member states. On the contrary, the last few years have seen a revival of Commission interest in this area. For example, Erkki Liikanen, European Commissioner for Enterprise and Information Society, boldly claimed that '[t]he task of the European Commission is to ensure the existence of the conditions necessary for the competitiveness of all Community industries. As this activity falls under the Union's First Pillar, this clearly allows us to develop proposals designed to enhance the competitiveness of the European defence industry.'<sup>40</sup> In January 2001 the Commission asked senior aerospace industry executives to prepare a report detailing an R&D strategy that would place European industry in a dominant global position within 20 years. *European aeronautics: a vision for 2020* acknowledges the synergies between civil and military aeronautics, and calls for increased EU financial support for R&D to offset the decline in defence spending by member states.<sup>41</sup> Even the Council is aware of these synergies—in March 2002, against the reservations of the United States, it decided to proceed with the €3.6 billion Galileo satellite navigation system, which has potential military applications.<sup>42</sup> Competition among the EU's institutions to forge a defence industrial policy will continue and intensify.

The second issue concerns the relative influence of government and business in shaping the evolution of the defence sector. Today, defence industry restructuring is largely a private sector concern, with a less direct role for national governments than existed a decade ago. As Burkhard Schmitt put it, 'What is novel about this ... movement towards greater Europeanisation of defence matters is undoubtedly the reversal of roles: it is no longer governments that are steering European cooperation on armaments but industry itself that is moving ahead of political constraints and adapting them, precipitating change and now acting as a driving force in the implementation of a common defence.'<sup>43</sup>

This does not mean, though, that European governments cannot work together on defence industrial issues on an ad hoc basis. One of the more promising developments in recent years has been the letter of intent (LOI) and the follow-up framework agreement signed by the defence ministers of the EU's six largest arms-producing countries: France, Germany, Italy, Spain, Sweden and

<sup>39</sup> 'GE/Honeywell: engine failure', *The Economist*, 7 July 2001, pp. 58–9.

<sup>40</sup> Erkki Liikanen, 'The role of the EU and European Commission initiatives to promote a competitive European defence technological and industrial base', speech given by European Commissioner for Enterprise and Information Society to Forum Europe 5th European Defence Industries Conference, Brussels, 23 May 2000.

<sup>41</sup> Commission of the European Communities, *European aeronautics: a vision for 2020. Report of the group of personalities*, Luxembourg: Office of Official Publications of the European Communities, Jan. 2001.

<sup>42</sup> Daniel Dombey, 'EU to go ahead with satellite system', *Financial Times*, 27 March 2002, p. 4.

<sup>43</sup> Burkhard Schmitt, *From cooperation to integration: defence and aerospace industries in Europe*, Chaillot Paper 40 (Paris: Institute for Security Studies, Western European Union, July 2000), p. v.



the UK.<sup>44</sup> These were the product of concern that Europe's defence industry was too fragmented, and that Europe's defence ministries would find themselves under increasing pressure to buy from US weapons producers. While it may yet be too much to claim that the LOI 'was definitely the event destined to have the greatest potential impact on the European defence market',<sup>45</sup> the initiative does cover all the major aspects of the military market: procurement security, export procedures, protection of classified information, R&D, exchange of technical information, standardization of military requirements and legal relations. Industry executives are in general agreement that Europe needs more cooperation in defence. The Society of British Aerospace Companies has called for a common European defence procurement policy to aid industry rationalization, albeit one that does not foster a 'fortress Europe' mentality that would aggravate US–Europe relations.<sup>46</sup>

Governments also play a key role in defence spending. Industry restructuring and ESDP are likely to do little to close the 'NATO–EU capabilities gap' unless national governments increase their defence budgets, which were slashed during the 1990s in pursuit of the post-Cold War 'peace dividend' and the drive to achieve the budgetary stipulations of EMU.<sup>47</sup> The 15 current EU members spent a combined \$205 billion on military expenditures in 1991, which dropped to \$175 billion in 2001—a decline of 15 per cent.<sup>48</sup> Aggregate numbers conceal the fact that military spending dropped 28 per cent in Germany, 24 per cent in the UK and 13 per cent in France over this period.

Member states have begun to take some of the actions necessary for a serious ESDP. Multinational cooperation has begun in key equipment purchases, particularly the Airbus A400M transport aircraft and the multi-role armoured vehicle (MRV). Cooperation in weapons procurement will be a key test for the successful fusion of ESDP and defence industry consolidation. In September 1998 France, the UK, Germany and Italy signed an agreement giving a legal identity to a joint European armaments organization (commonly known by its French acronym—OCCAR). European defence ministries, particularly the British, have often been tempted to buy American rather than European. The UK's May 2000 decisions to buy the European Meteor missile (rather than Raytheon's AMRAAM) and Airbus A400M military transport plane (rather than the C103J from Lockheed or C17 from Boeing), despite the fact that the Meteor is not yet being produced and the A400M is still in the development

<sup>44</sup> 'Letter of intent among six defence ministers on measures to facilitate the restructuring of the European defence industry', 2000: <http://projects.sipri.se/expcon/loi/loisign.htm>; 'Framework agreement between the French Republic, the Federal Republic of Germany, the Italian Republic, the Kingdom of Spain, the Kingdom of Sweden and the United Kingdom of Great Britain and Northern Ireland concerning measures to facilitate the restructuring and operation of the European defence industry', 2000: <http://projects.sipri.se/expcon/loi/indresto2.htm>.

<sup>45</sup> Michele Nones, 'A test bed for enhanced cooperation: the European defence industry', *International Spectator* 35: 3, July–Sept. 2000, p. 28.

<sup>46</sup> Alexander Nicoll, 'Aid for defence rationalisation urged', *Financial Times*, 27 Aug. 1998, p. 4.

<sup>47</sup> Heisbourg, 'Europe's strategic ambitions'; Yost, 'The NATO capabilities gap and the European Union'.

<sup>48</sup> Information from SIPRI: [http://first.sipri.org/non\\_first/result\\_milex.php](http://first.sipri.org/non_first/result_milex.php) (figures in 1998 dollars).

stage, can be interpreted as a sign that the country is serious about European defence collaboration.<sup>49</sup> However, Italy's withdrawal from the A400M military transport aircraft project, and Germany's decision to fund only 40 of the 73 planes it had originally agreed to purchase, underscore the difficulties associated with sustaining collaborative weapons programmes. There is also cause for concern in slow economic growth and the budget tightening brought on by EMU's Growth and Stability Pact, which have made most EU member state governments wary of increasing defence budgets, even in the wake of the 11 September terrorist attacks.

Unfortunately, previous efforts to institutionalize (or at least coordinate) defence procurement have yielded a litany of acronyms but few tangible accomplishments. The WEU's Western European Armaments Group (WEAG), itself a successor to the Independent European Programme Group (IEPG) formed in 1976 by European members of NATO, set up the Western European Armaments Organization (WEAO), a likely forerunner of a future European Armaments Agency (EAA), in 1996 to manage defence research projects, procure contracts and provide the WEAG with research and technological support. Discussions on integrating the WEAG and WEAO, as well as OCCAR, into existing EU structures must be seen in the context of the EU Commission taking greater initiative in the armaments field.<sup>50</sup> If brought about successfully, the institutionalization of defence procurement, which would also build upon the LOI and framework agreement, would be the nucleus of enhanced defence cooperation in Europe.

Third, restructuring will continue to be influenced by technology. Change has been most rapid in the aerospace and electronics sector, as seen in the British Aerospace–GEC linkup and the formation of EADS. By contrast, very little has occurred in land or naval systems.<sup>51</sup> Europe's naval shipyards are almost entirely national. The UK land industry is divided between Alvis (part of Rolls Royce) and Royal Ordnance (a division of BAE Systems). In Germany, it is split between two family-dominated companies: Krauss Maffei Wegmann and Rheinmetall. State-owned Giat dominates land armaments in France. One explanation for these divergent developments holds that aerospace and land armaments have followed different paths for economic and political reasons.<sup>52</sup> Rapidly increasing R&D costs and shorter production runs made cross-border cooperation in the aerospace sector a financial imperative in the 1960s, and intergovernmental programmes structured the sector in the following decades. More modest increases in R&D costs, relatively longer production runs and little competition from civilian markets meant that the land armaments sector

<sup>49</sup> Howorth, 'Britain, France, and the European Defence Initiative'; Nones, 'A test bed for enhanced cooperation'.

<sup>50</sup> Nones, 'A test bed for enhanced cooperation'.

<sup>51</sup> Alexander Nicoll, 'EADS calls for European rationalisation', *Financial Times*, 26 March 2001, p. 24.

<sup>52</sup> Jan Joel Andersson, *Cold War dinosaurs or hi-tech arms providers? The west European land armaments industry at the turn of the millennium*, occasional paper no. 23 (Paris: Institute for Security Studies, Western European Union), Feb. 2001.

has only recently come under pressure to restructure. Since land and naval systems are essentially 'old-economy' structures whose value is increasingly determined by the 'new-economy' electronics installed within them, it is commercially logical for large defence electronics companies to make acquisitions in these sectors. Northrop Grumman became the largest builder of naval ships in the United States when it acquired Newport News in 2001. EADS is now interested in playing such a role in Europe.<sup>53</sup>

Fourth, since the political economy of transatlantic relations is characterized by competition as well as cooperation,<sup>54</sup> the United States will play a fundamental role in determining the success—perhaps even the survival—of Europe's defence industrial base. On an economic level, the US defence industry has probably consolidated as much as it can domestically, Northrop Grumman's recent acquisition of TRW notwithstanding. A next step would be transatlantic ventures. While Europe may be ripe for some additional restructuring, particularly in land and naval systems, the regional consolidation path followed to date is not without its critics.<sup>55</sup> Several argue that building transatlantic partnerships is preferable to the formation of European defence giants, because European firms engaged in transatlantic collaborations would become more likely to participate in US defence projects, and because it would reduce the likelihood of a 'fortress Europe', whereby European defence ministries would procure few (if any) US-manufactured weapons systems. Others contend that the wave of mergers in the US has failed to reduce excess production capacity, and that lobbying savvy in Washington deserves more credit than corporate restructuring for the industry's success in the post-Cold War period.<sup>56</sup> Such arguments for transatlantic ventures, however, hinge on the willingness of the United States to permit European (as opposed to British) acquisitions of US defence firms, and to award major weapons contracts to European firms or consortia. There is as yet little evidence of either.

At the political level of transatlantic relations, there is a need to reconsider the relationships between institutions, and then to equip them with the means to undertake policies appropriate for the evolution of Europe's defence industry.<sup>57</sup> For example, while EU members have pledged to develop a rapid reaction force, how that institution would undertake a military operation is not yet clear. This is particularly worrisome given that the EU has announced its availability to take over command of the NATO-headed multinational force currently

<sup>53</sup> Nicoll, 'EADS calls for European rationalisation'.

<sup>54</sup> Terrence Guay, *The United States and the European Union: the political economy of a relationship* (Sheffield: Sheffield Academic Press, 1999); John Peterson, *Europe and America: the prospects for partnership*, 2nd edn (London: Routledge, 1996); Mark A. Pollack and Gregory C. Shaffer, eds, *Transatlantic governance in the global economy* (Lanham, MD: Rowman & Littlefield, 2001).

<sup>55</sup> Deutch et. al., 'Saving NATO's foundation'; Charles Grant, 'Storm the barricades', *Worldlink*, July–Aug. 1999, <http://backissues.worldlink.co.uk/articles/29061999100635/07.htm>; Harvey Sapolsky and Eugene Gholz, 'Arms and the European', *Financial Times*, 20 May 1998, p. 12.

<sup>56</sup> Eugene Gholz and Harvey M. Sapolsky, 'Restructuring the US defence industry', *International Security* 24: 3, Winter 2000, pp. 5–51.

<sup>57</sup> Andréani Gilles, 'Why institutions matter', *Survival* 42: 2, Summer 2000, pp. 81–95.

deployed in Macedonia.<sup>58</sup> Nor is there much clarity on sensitive issues such as how non-EU members of the now extinct WEU will interact with the EU, as the EU moves to take over many of the WEU's functions and security guarantees. The relationship between the newly security-conscious EU and NATO is also another potential source of controversy.<sup>59</sup> Fundamentally, there remains a need to persuade US officials, particularly in the Bush administration, that an EU defence policy will not undermine NATO or US interests in Europe. Indications to date suggest that this will be no easy task.

## **Conclusion**

Transformation of the European defence industry has been a long and difficult process. Politics and national egos, along with an unwillingness to face economic realities, have long delayed what Harold Wilson, speaking over thirty years ago, knew was inevitable:

There is no future for Europe, or for Britain, if we allow American business and American industry so to dominate the strategic growth industries of our individual countries that they, and not we, are able to determine the pace and direction of Europe's industrial advance, that we are left in industrial terms as the hewers of wood and drawers of water while they, because of the scale of research, development and production which they can deploy, based on the vast size of their single market, come to enjoy a growing monopoly in the production of the technological instruments of industrial advance ... this is the road not to partnership but to an industrial helotry.<sup>60</sup>

For decades, Europe was closer to helotry than partnership, the road to helotry paved with the good intentions of small, national defence industries that could not compete on the world stage without the threat of duelling superpowers. We have identified four factors that began the process of moving Europe's defence industry beyond wood-hewing and water-drawing. It should be evident that these are not independent variables. Certainly they are linked, and an argument could be made that the external forces influenced the timing of the EU-specific factors. Keith Hayward contends that the globalization process is creating or accelerating the emergence of transnational defence markets and corporate structures in all countries with a defence industrial base.<sup>61</sup> However, emphasizing external forces alone provides an insufficient explanation for the particularities of the European case, especially since the globalization argument would not necessarily imply consolidation occurring almost exclusively among the defence companies of EU member states. The fact that transatlantic (as well

<sup>58</sup> 'Presidency conclusions Barcelona European Council 15 and 16 March 2002', [http://europa.eu.int/comm/external\\_relations/w12/1.htm#fyrom](http://europa.eu.int/comm/external_relations/w12/1.htm#fyrom).

<sup>59</sup> Kori Schake, Amaya Bloch-Laine and Charles Grant, 'Building a European defence capability', *Survival* 41: 1, Spring 1999, pp. 20–40.

<sup>60</sup> Quoted in Roger Facer, *The alliance and Europe, Part III: weapons procurement in Europe—capabilities and choices* (London: International Institute for Strategic Studies, 1975), p. 32.

<sup>61</sup> Keith Hayward, 'The globalisation of defence industries', *Survival* 42: 2, Summer 2001, pp. 115–32.

as EU and non-EU) corporate ties in this sector remain fairly weak requires us to look to supplemental explanations. The role of institutions (particularly the EU) and the dynamics of regional economic and political integration can complete the picture.

Transatlantic corporate ties may be weak today, but in the future we expect them to strengthen. In fact, the future of the European defence industry may lie across the Atlantic, not as hewers and drawers, but as full partners. For example, BAE Systems is a partner along with Northrop Grumman in the Lockheed Martin-managed Joint Strike Fighter programme, which will provide \$200 billion worth of planes to the Pentagon and generate hundreds of billions of dollars more in exports. BAE Systems and EADS will in time become both collaborators and competitors in an Atlantic defence market that sees European entities as true global forces, in much the same way that Boeing has come to respect, and fear, Airbus. Such an outcome would surely make Sir Harold Wilson proud.